

Key points

- The employer and members of a scheme can contractually agree that the member's entitlement under the scheme will be different to that under the scheme rules
- The case of *South West Trains v Wightman* established that such "extrinsic contracts" could be effective
- Extrinsic contracts cannot affect benefits which it is agreed have been earned by members' employment before the extrinsic contract is concluded, because of section 91 of the Pensions Act 1995
- Extrinsic contracts can be useful for employers looking to make changes to future pension benefits but they should always be used with care and only after taking legal advice

Main sources

- *South West Trains v Wightman* [1997] EWHC 1160 (Ch)
- *Bradbury v BBC* [2012] EWHC 1369 (Ch)
- *Briggs v Gleeds* [2014] EWHC 1178 (Ch)
- Pensions Act 1995

What is an extrinsic contract?

An extrinsic contract in relation to a pension scheme is an agreement between a member of the scheme and their employer that the member will receive benefits different to those set out in the scheme rules. The agreement will usually

be in the member's contract of employment, or a variation to it.

The principle that benefits under a scheme could be varied by extrinsic contracts was established in the case of *South West Trains v Wightman*.

When are extrinsic contracts used?

Extrinsic contracts are most commonly used as a way of employers awarding pay increases which are not pensionable – the employer offers a pay increase to a member on condition that they agree it is not taken into account for the purposes of their pension benefits.

Extrinsic contracts are also sometimes used as an attempt to agree amendments to other benefits which the member will earn in respect of their future service with the employer.

Extrinsic contracts might also be used in an attempt to cure a defective amendment to a scheme - where a change to the rules was previously attempted but was ineffective for some reason, employers often argue that the member also contractually agreed to the amendment (by, for example, returning a signed option form).

What are the requirements of an extrinsic contract?

Extrinsic contracts are individual arrangements – so whether a member's pension benefits are subject to an extrinsic contract is judged individually. For an extrinsic contract to be valid, it will need to meet the requirements of a contract, i.e. that:

- there is an offer by the employer – which should at least offer an alternative option to the member, even

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if it is not attractive (e.g. offering the option of a salary increase which is not pensionable, or no increase at all);

- the offer is accepted by the member – this will need to be active acceptance (for instance returning a signed form selecting an option): a member just failing to object to an employer's proposal is unlikely to be taken to have accepted the offer;
- there is consideration – something of value passes between the parties to the contract;
- there is an intention to create legal relations – the employer will need to ensure that members understand that they are making a choice and that the employer is not merely announcing what it is going to do (that the change is not a "fait accompli"). Employees will also need to understand that this is a choice being made outside of the scheme rules – they are not being asked to exercise an option given to them under the rules; and
- there is certainty of terms - preferably the terms are contained in the form the member signs.

Restrictions on extrinsic contracts

Section 91 of the Pensions Act 1995 prevents members from, among other things, surrendering a pension entitlement or right to a future pension.

Members cannot therefore agree to give up pension they have already earned (although this is subject to some limited exceptions). Extrinsic contracts cannot therefore be used to alter members' established pension rights in respect of their employment before the date of the agreement.

Section 91 does not restrict agreements that future pay increases not be pensionable – the case of *BBC v Bradbury*

confirmed that employees had no right to future salary increases so such an agreement would not involve the employee surrendering any right they had.

The position on altering benefits (aside from pensionable salary) for future service is not clear – the general view is that section 91 will not prevent employees giving up rights in respect of future service but such exercises should be approached with care.

Where the extent of a member's existing pension rights is genuinely in dispute, the courts currently allow those rights to be altered by extrinsic contract without falling foul of section 91.

When should an extrinsic contract be used?

The safest way to amend employees' pension benefits is through a valid change to the rules of the scheme (complying with the terms of the power of amendment). Making amendments to employees' pension benefits without amending the scheme will always involve some risk.

Extrinsic contracts can be useful, particularly when dealing with awarding non-pensionable pay increases, where an employer is having difficulty persuading trustees to agree to changes which members would not significantly object to or as a means of resolving genuine disputes as to the extent of a member's pension benefits.

Extrinsic contracts should not be used to try to alter benefits employees have already earned and should be used with care where there is some doubt as to whether a change could be made to the scheme within the power of amendment.

Whilst extrinsic contracts can therefore be useful for employers, they should always be used with care and only after taking legal advice.

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